

# PUBLICATION

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## Proper Use of Letters of Intent

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The parties to purchase or lease transactions involving long term care facilities frequently sign letters of intent<sup>1</sup> as a preliminary step in completing the transaction. Drafted carefully, letters of intent enhance the negotiation phase of the transaction process. On the other hand, poorly drafted letters of intent may lead to claims of breach of oral, written or implied contract, fraud and misrepresentation.

Letters of intent serve a number of important functions. They can give both parties comfort that the other side is motivated to complete the transaction. They can also focus the negotiation by defining a number of deal terms on which the parties have agreed, as well as highlighting areas where further negotiation will be necessary before the parties can enter into a definitive agreement. Typical deal terms included in a transaction letter of intent include the purchase price and how it is to be paid, assets to be acquired, non-competition terms, financing contingencies, exclusivity of dealing, confidentiality and a closing date. Letters of intent pose some level of legal risk and should not be entered into without careful consideration. For example, a poorly drafted letter of intent may, if negotiations break down, allow one of the parties to take the position that the letter amounts to a binding contract rather than a statement of intent, thereby entitling it to damages for breach by the other party. When that happens, litigation often will result, and a court will have to interpret the legal effect of the parties' words and actions. Unless the letter of intent is clearly written, the fact that the parties contemplated the later execution of a definitive agreement will not necessarily mean a court will find that all prior agreements between them were merely unenforceable negotiations. See, *Texaco; W.R. Grace & Co.-Conn., et al. v. Taco-Tico Acquisition Corporation, et al.*, 216 Ga.App. 423, 454 S.E.2d 789 (1995) (GA).

### Binding vs. Non-binding Provisions

Although buyers and sellers frequently refer to letters of intent as being "non-binding," certain provisions of the letter of intent should be binding. The following provisions, customarily found in letters of intent concerning the purchase and sale of long term care facilities, generally should be binding:

- **Exclusivity** – Strategically, a buyer will want the exclusive right to negotiate with the seller for a certain period of time. Otherwise, the seller would be able to shop the deal to others, resulting in a possible bidding war or auction-type process that drives the purchase price up and increases transaction costs. If its negotiating leverage will allow, a buyer should insist on a binding exclusivity provision in the letter of intent that lasts for some reasonable period of time to allow the parties to hammer out the definitive agreement terms. The challenge for the draftsman is to specify what exactly is covered by the exclusivity provision. From the buyer's perspective, it should prohibit the seller from actively soliciting offers as well as receiving proposals. From the seller's perspective, the exclusivity provision of the letter of intent should allow the seller to negotiate with a third party when necessary to allow the Board of Directors to comply with its fiduciary obligations to the seller.
- **Confidentiality Covenant** – The seller of a long term care facility generally wants to keep negotiations confidential for as long as possible to prevent its employees from becoming preoccupied with the ramifications of the sale and to maintain their loyalty. From the seller's perspective, the letter of intent should specify one individual at the seller's business through whom all of the buyer's requests for information are to be channeled, and the letter should flatly prohibit the buyer from contacting any of

the seller's employees prior to a pre-determined stage in the transaction (usually after execution of a definitive agreement and a public announcement of the proposed transaction).

- **Non-Solicitation Covenant** – During the course of its due diligence, a buyer often will learn information about specific employees of the seller, whether on its management team or at the facility. The seller will want to include in the letter of intent a binding provision that in the event the transaction is not consummated, the buyer is prohibited from soliciting or hiring the seller's employees. A buyer will seek to limit the general non-solicitation prohibition by allowing the buyer to hire employees of the seller in connection with any generally advertised job postings.
- **Standard Applicable to Negotiations** – Some courts are reluctant to find an implied duty on parties to negotiate in good faith. Accordingly, the letter of intent should expressly state whether the parties are required to negotiate in good faith for some period of time, after which either party may terminate negotiations for any reason. In the event of such a termination, the letter of intent should state that the confidentiality and non-solicitation covenants survive the termination for some period of time.

As for those business terms that the parties do not intend to be binding, the letter of intent should expressly disclaim any contractual effect regarding those specific terms. To prevent any misunderstanding concerning the binding and non-binding provisions of the letter of intent, the provisions that are intended to be binding and enforceable should be physically separated from the non-binding provisions of the letter by laying them out in a separate part of the letter. The letter also should contain a separate paragraph that specifically states which of the binding provisions survive expiration of the letter of intent, and for how long.

When drafted casually or loosely, letters of intent can create confusion and uncertainty and lead to litigation. When drafted carefully and deliberately, letters of intent can focus the parties' attention and streamline the entire negotiation process.

<sup>1</sup> *Letters of intent may be referred to in a given transaction as an expression of interest, term sheet, memorandum of understanding or other name. Although parties may intend subtle differences with these terms, for simplicity of reference, this article will refer to all such writings as letters of intent.*